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Delaware Court Finds Reverse Triangular Merger Does Not Violate Contractual Prohibition on Assignment by Operation of Law

By Michael O'Bryan and Ted Powers

The Delaware Chancery Court, in *Meso Scale Diagnostics, LLC v. Roche Diagnostics GmbH* (Feb. 22, 2013), held that the acquisition of a company in a reverse triangular merger did not violate a restriction in an existing agreement of the target company that prohibited assignments by operation of law.

The decision reaffirms the traditional assumption that, in most circumstances, the acquisition of a company through a reverse triangular merger does not violate anti-assignment provisions in the target company's underlying agreements. In part because of that assumption, reverse triangular mergers are one of the most common M&A structures. In a reverse triangular merger, the acquiror forms a shell company and merges the shell company into the target company, with the shell company disappearing and the target company surviving as a wholly-owned subsidiary of the acquiror.

The decision provides welcome relief to those planning acquisitions after the court, in an earlier proceeding in the same case, had questioned the assumption by refusing to find as a matter of law that a reverse triangular merger is not an assignment (Apr. 8, 2011). Some limits to the applicability of the assumption remain, however, depending on applicable law and other factors.

BACKGROUND

In 2007, Roche acquired BioVeris in a transaction structured as a reverse triangular merger, in which a newly formed subsidiary of Roche merged into BioVeris, with BioVeris surviving as a wholly-owned subsidiary of Roche. Roche apparently intended in the merger primarily to obtain certain IP rights held by BioVeris, and after the merger closed soon shut down BioVeris' operations.

Plaintiff Meso had rights in the IP held by BioVeris, and claimed that Roche's acquisition of BioVeris violated the anti-assignment provision of a Global Consent that had been entered into by Roche, Meso, BioVeris, and others in 2003, when BioVeris granted Roche a limited license to the IP. The Global Consent included a provision prohibiting assignment "of the rights, interests or obligations under [the Global Consent] ... in whole or in part, by operation of law or otherwise ...," but did not include language otherwise purporting to prohibit a change of control of BioVeris or to treat a change of control as an assignment.

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BIOVERIS MERGER IS NOT AN ASSIGNMENT BY OPERATION OF LAW OR OTHERWISE

The court noted that no Delaware court had addressed whether a reverse triangular merger “could ever” constitute an assignment by operation of law. The court also noted that in interpreting the anti-assignment provision it would try to determine the parties’ “collective intent.”

The court began by stating that “[g]enerally, mergers do not result in an assignment by operation of law of assets that began as property of the surviving entity and continued to be such after the merger.” The court noted that the Delaware General Corporation Law provides that, in a merger, the separate existence of the constituent corporations, other than the surviving corporation, ceases, and the assets and rights of the constituent corporations are vested in the surviving corporation (§ 259), suggesting that the surviving corporation does not effect any assignment. The court also concluded, under the “objective theory” of contract interpretation, after looking at the commentary discussing reverse triangular mergers, that this interpretation was consistent with the reasonable expectations of the parties.

The court distinguished cases cited by Meso involving forward triangular mergers, since in those cases the target was not the surviving company in the merger. The court also declined to adopt the holding in *SQL Solutions, Inc. v. Oracle Corp.* (N.D. Cal. 1991), which applied California law and federal IP principles and held that a reverse triangular merger resulting in the acquisition of SQL by Sybase constituted a transfer of rights under a software license from Oracle held by SQL. The court noted that following the *SQL* approach would “[upset] Delaware’s well-settled law” that stock acquisitions, by themselves, do not result in an assignment by operation of law.

IMPLICATIONS

Clearer Line Generally for Reverse Triangular Mergers. *Meso* shows that, under Delaware law, a reverse triangular merger generally does not violate anti-assignment provisions in a target company’s agreements, even if the anti-assignment provisions prohibit assignment by operation of law. While the opinion provides greater clarity, given the court’s reasoning, practitioners should still consider the intent of the parties to the target company’s agreements, particularly if there are ambiguities in the relevant provisions of those agreements.

Applicable Law Matters. The court reached its conclusion after examining the effect of a merger under Delaware’s merger statute and the interpretation of an anti-assignment provision under Delaware law. While Delaware’s law is not unusual, the effect of a merger in other jurisdictions, and the interpretation of contracts governed by other laws, should be confirmed when planning for an acquisition.

Intellectual Property Law Context. The contracts at issue in *Meso* related to BioVeris’ IP rights, but the court did not discuss federal IP principles. However, other IP related cases, such as *SQL*, have noted the restrictive nature of federal IP rules. Practitioners should continue to consider federal IP rules in considering anti-assignment provisions in licenses and other IP agreements.

Drafting Anti-Assignment Provisions. Outside the M&A context, when drafting a company’s commercial and other agreements, parties should consider clarifying the impact of various acquisition structures, for example, if applicable, by adding explicit change of control provisions or by expressly allowing some forms of acquisition.

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Contact:

Michael O'Bryan

(415) 268-6352

mobryan@mofo.com

Ted Powers

(212) 336-4439

tpowers@mofo.com

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